

ORIGINAL

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of Applications for Consent )  
to the Transfer of Control of Licenses and )  
Section 214 Authorizations from Ameritech )  
Corporation, Transferor, to SBC )  
Communications Inc., Transferee )

CC Docket No. 98-141

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## EXECUTIVE SUMMARY

SBC and Ameritech's gambit is simple: if the Commission approves their merger, they will increase local competition by entering local markets outside their regions because out-of-region competition is essential to retain critical in-region business customers with locations around the country, and the merger would give them the scale they need to engage in this "national local" strategy; but if the Commission denies their application, they will passively allow competitors to capture their "national local" customers, continue not to compete against other major incumbent local exchange carriers ("ILECS") in their monopoly local markets, and use their enormous resources for other unidentified purposes.

The Commission should call SBC and Ameritech's bluff. If SBC and Ameritech view out-of-region competition as critical to their future viability, each of these lucrative and cash-rich monopolies will find a way to finance on its own the \$2 billion investment they claim is required. After all, new entrants like MCI WorldCom which lack a steady torrent of monopoly profits have already invested billions of dollars to pry open the local markets that SBC and Ameritech have dominated for so long. SBC and Ameritech claim that if they compete in other ILECs' regions, those ILECs will be forced to compete against them in their combined region. But those ILECs are all smaller than the combined SBC-Ameritech (unless the Bell Atlantic-GTE merger is allowed to proceed), and if they can afford to compete in SBC's and Ameritech's region, SBC and Ameritech do not need to merge in order to afford to compete against them in the first instance.

The Commission may reasonably ask whether SBC and Ameritech will compete out-of-region in any circumstances if the effect would be to trigger entry by incumbents in those markets into SBC's and Ameritech's regions. The likelihood of such a competitive response to out-of-region competition appears to have persuaded all of the major incumbents *not* to compete in each

other's monopoly markets. SBC and Ameritech's relentless and effective efforts to frustrate implementation of the Telecommunications Act of 1996 indicate that their top priority is to prevent competition against them.

But if SBC and Ameritech believe that the benefits to their in-region business from competing out-of-region outweigh the potential cost of increased in-region competition stimulated by out-of-region forays, SBC and Ameritech will find a way to finance out-of-region competition — with or without the merger. Conversely, if SBC and Ameritech would not find it in their overall economic interests to compete out-of-region without the merger, they will not compete out-of-region even if they merge. The merger is essentially irrelevant to the likelihood that SBC and Ameritech will compete outside their current regions.

In fact, the merger is not about increasing out-of-region competition; it is about decreasing in-region competition. The effect, if not the intent, of the proposed merger would be to raise the barriers to local competition within SBC's and Ameritech's regions by consolidating their monopolies. The proposed merger would give SBC and Ameritech monopoly control of over one-third of the nation's total access lines. As their application makes clear, SBC's and Ameritech's major goal is defensive, not offensive — to hold on to major business accounts that are based in their regions and that want one company to provide facilities-based local services at all of their locations inside and outside their regions. By enabling SBC and Ameritech immediately to provide facilities-based local service at a higher percentage of these customers' locations without any additional investment or reliance on out-of-region ILECs, the merger will increase SBC's and Ameritech's advantage over CLECs that must undertake the lengthy and expensive process of building out their networks to many of these diverse locations and must depend on the ILEC to reach the rest. SBC's and Ameritech's "national local" strategy, is

nothing more than an attempt to take advantage of the current lack of local competition in their regions — and to preempt its further development — by locking up the business of the nearly half of the Fortune 500 companies with headquarters in their regions.

The merger would also significantly reduce the ability of regulators, and competitors, to benchmark the performance of SBC and Ameritech. As the Commission recognizes, benchmarking is an important tool that helps regulators enforce rules requiring incumbent local carriers both to treat new local entrants reasonably and nondiscriminatorily and to provide exchange access services efficiently. The elimination of yet another large ILEC through merger would mean that there will be fewer points of comparison. The end result may be the worst of both worlds, with SBC-Ameritech selecting the lowest common denominator in those instances where SBC and Ameritech currently have different policies or practices and one is more competition-friendly than the other.

The anticompetitive effects of combining these two companies' local exchange monopolies would be exacerbated and expanded into the long distance market if SBC and Ameritech receive section 271 authority to offer long distance service in their combined region while they still monopolize local exchange and exchange access services. By controlling both ends of a higher percentage of interLATA calls, SBC-Ameritech would be able to discriminate more effectively against rival long-distance companies and thereby obtain market power in long distance services.

Furthermore, the direct consequence of permitting this merger to occur would be the elimination of both potential, and even nascent actual, competition between two companies that contend that competing out of region is *vital* to each company's competitive future. If SBC and Ameritech believe that a "national local" strategy is essential to hold on to key in-region business

customers, and if the proposed merger is not approved, both SBC and Ameritech doubtless would find a way to compete in at least some cities outside their regions, including cities in each other's regions. After all, four of the top ten local markets are in SBC's territory, and two are in Ameritech's. SBC would be an especially significant competitor in Ameritech's region, and vice versa. Elimination of new entry that could make a significant difference to local customers in each region is, by itself, sufficient grounds for declining to approve the transfer of control.

Equally important, the Commission should carefully examine the consequences for competition in Internet services if this merger is allowed to proceed. ILECs have bottleneck control over the initial link between Internet users and the Internet — the local loop. Their monopoly control extends to xDSL services. Even if ILECs do not receive the regulatory concessions that they are seeking in the Section 706 proceedings, the limited availability of xDSL-capable loops and collocation on reasonable and nondiscriminatory terms makes impossible as a practical matter widespread competition to provide xDSL services, especially to residential and small business customers, and there appears to be little likelihood that these problems will be solved quickly. With this lack of effective competition, the ILECs are leveraging their monopoly control over xDSL services into the Internet by tying their xDSL and Internet services.

If xDSL services become a predominant method of providing access to the Internet, SBC's and Ameritech's monopoly control over xDSL services, coupled with their bottleneck control over other local services used to access the Internet, would enable them to achieve significant power over Internet services. The merger would give SBC and Ameritech control over access to one-third of all Internet customers in the United States — the same as a combined Bell Atlantic-GTE and more than any other company. SBC-Ameritech's power over a substantial and disproportionate percentage of Internet customers may give it, especially along with a merged

Bell Atlantic-GTE, a major advantage in bargaining to exchange traffic with smaller Internet companies and in capturing the business of Internet users and content providers.

If the ILECs were to succeed in their efforts to apply the current access charge regime to Internet traffic on their local networks by reclassifying it as interstate, the threat that the merger poses to Internet competition would be greater still. This attempt to raise the costs of competing Internet Service Providers (“ISPs”) by itself demonstrates that ILECs will seize any opportunity to burden ISPs and suppress Internet competition. With control over access to one-third of the nation’s Internet users, the merged SBC-Ameritech could use price squeezes and other discrimination to gain an even greater and more disproportionate share of Internet traffic, and concomitant power over Internet consumers and competitors.

As indicated above, SBC’s and Ameritech’s merger cannot be viewed independent of other proposed mergers among ILECs. If the pending Bell Atlantic-GTE merger is permitted to proceed along with the SBC-Ameritech merger, the two resulting companies could together dominate the provision of local telephone service — and possibly even bundled local, long-distance, wireless, and Internet service. Moreover, if the Commission approves all of the pending ILEC mergers, on what principled basis would it disapprove SBC’s subsequent acquisition of U S West, or even a merger of SBC-Ameritech-PacBell-SNET and BA-NYNEX-GTE-PRTC? And if the resulting mega-BOC is allowed to provide long-distance services (and obtain manufacturing authority that would follow automatically under section 273), the Commission will have permitted the BOCs to recreate the former Bell System. The 1996 Act was not intended to turn back the clock to the days when the Bell System monopolized all facets of telecommunications. When it approved the Bell Atlantic-NYNEX merger, the Commission made clear that at some point it would draw the line. Now is the time, and here is the place, to draw this line.



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**COMMENTS OF MCI WORLDCOM, INC.**

MCI WORLDCOM, Inc. ("MCI WorldCom") hereby submits its comments opposing the joint application of SBC Communications, Inc. ("SBC") and Ameritech Corporation ("Ameritech") for approval of their proposed merger.

**I. SBC AND AMERITECH HAVE THE BURDEN TO PROVE THAT THEIR PROPOSED MERGER WILL ENHANCE COMPETITION IN AFFECTED MARKETS.**

Under its now well-established standards for merger reviews, the Commission must determine whether SBC and Ameritech have carried their burden to prove by a preponderance of the evidence that their merger would affirmatively serve the public interest.<sup>1/</sup> The competitive issues presented by the proposed merger are at the heart of the Commission's analysis. The

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<sup>1/</sup> See *In re Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, CC Docket No. 97-211, FCC 98-225, ¶¶ 8, 10 (rel. Sep. 14, 1998) ("MCI-WorldCom Order"); *In re Application of Teleport Communications Group Inc., Transferor, and AT&T Corp., Transferee For Consent to Transfer Control of Corporations Holding Point-to-Point Microwave Licenses and Authorization to Provide International Facilities Based and Resold Communications Services*, Memorandum Opinion and Order, 12 Communications Reg. (P&F) 1095, ¶ 11 (rel. July 23, 1998); *In re Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, 12 F.C.C.R. 19985, ¶¶ 29-36 (1997) ("BA-NYNEX Order").

public interest standard includes “the implementation of Congress’ pro-competitive, de-regulatory framework national policy designed to . . . open[] all telecommunications markets to competition.” *MCI-WorldCom Order* ¶ 9 (internal quotations omitted). “In order to find that a merger is in the public interest, [the Commission] must, for example, be convinced that it will enhance competition.” *BA-NYNEX Order* ¶ 2.

The Commission also “shares jurisdiction with DOJ under sections 7 and 11 of the Clayton Act to disapprove acquisitions of common carriers.” *MCI-WorldCom Order* ¶ 8 n.23. Section 7 of the Clayton Act is a flexible and powerful weapon against anti-competitive mergers in evolving markets. It prohibits mergers whenever there is a reasonable probability that there would be less competition in a given market after a proposed merger than there would be if the merger did not occur. It “requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future.” *United States v. Philadelphia National Bank*, 374 U.S. 321, 362 (1963). Section 7 is intended to prevent not only the last in a series of mergers that results in actual monopoly, but to stop in its incipency a cumulative process the ultimate result of which may be a significant reduction in the vigor of competition. *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-18 (1962); *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957).

The Commission’s competitive inquiry is primarily concerned not with the status of competition now, but rather with the effect of the merger on competition in the future. SBC and Ameritech encourage the Commission to focus on the effect of the merger on competition in the market for local exchange and exchange access services. See Description of The Transaction, Public Interest Showing and Related Demonstrations, at 8-10 (“SBC-AIT Appl.”). With respect to this market, the question is not whether the proposed merger will make local markets less

competitive (after all, they could not be significantly less competitive than they are now), but whether it will help bring competition to those markets or stand in the way of those markets becoming more competitive. SBC and Ameritech do not address the potential effect of the merger on competition for Internet services. With respect to the Internet business, the question is whether, considered in the context of all relevant developments including other proposed and potential mergers among major incumbent local exchange carriers ("ILECs"), the proposed SBC-Ameritech merger will reduce currently robust competition among Internet service providers ("ISPs").

**II. CREATION OF A MEGA-BOC SERVING ONE-THIRD OF THE NATION'S ACCESS LINES WOULD MAKE COMPETITIVE ENTRY INTO LOCAL MARKETS EVEN MORE DIFFICULT.**

By any objective measure, SBC and Ameritech have monopoly control over local exchange access in their respective regions, and have effectively thwarted local exchange competition in their own regions for more than 2½ years. With this merger, they present a plan to the Commission that would allow them to keep that monopoly for years to come. Their much ballyhooed plan to compete out-of-region is in reality a limited plan to serve the peripheral offices of Fortune 500 companies located primarily in their expanded monopoly region. Especially when considered in conjunction with the proposed Bell Atlantic-GTE merger, it is clear that this merger will reduce local competition in numerous substantial ways.

**A. SBC and Ameritech retain monopoly control over local exchange access and have frustrated the opening of their markets to competition.**

That local competition is in its infancy in the regions controlled by SBC and Ameritech is beyond reasonable dispute. *See* Declaration of Kenneth C. Baseman and A. Daniel Kelley ¶¶ 16-

17 (attached hereto as Exh. 1) (“Baseman-Kelley Decl.”).<sup>2/</sup> The Commission recently found that “incumbent LECs continue to dominate the market for local exchange and exchange access service to business customers.” *MCI-WorldCom Order* ¶ 172. The Commission also found that in many places, “the incumbent LEC’s market share is or approaches 100 percent.” *Id.* ¶ 168. Neither SBC nor Ameritech has been granted section 271 authority to offer in-region long distance service because neither has come close to demonstrating to the Commission that its local exchange markets are open to competition.

With respect to Ameritech, the Commission found last year that, among the competitive checklist items that Bell Operating Companies (“BOCs”) must implement for CLECs, Ameritech had failed to provide nondiscriminatory access to its operations support systems (“OSS”), reasonable and nondiscriminatory interconnection, and nondiscriminatory access to its 911 and E911 services.<sup>3/</sup> Since the denial of its second Michigan application, Ameritech has not been back to the Commission seeking section 271 authority for any state in its region.

What Ameritech has done in the interim period is continue to wage an aggressive campaign within each of its in-region states in order to prevent local exchange competition from developing. One egregious example of this conduct is Ameritech’s refusal to provide shared transport to CLECs — a refusal that continues to this day despite the fact that state commissions,

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<sup>2/</sup> Even before the Telecommunications Act of 1996 was enacted, SBC mounted a massive lobbying campaign that led to passage of an anticompetitive law in Texas to cripple local competition. See *In re the Public Utility Commission of Texas, et al. Petitions for Declaratory Ruling and/or Preemption Of Certain Provisions of the Texas Public Utility Regulatory Act of 1995*, Memorandum Opinion and Order, 13 F.C.C.R. 3460, ¶ 24 (1997) (“PURA Decision”).

<sup>3/</sup> *In re Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Michigan*, Memorandum Opinion and Order, 12 F.C.C.R. 20543, ¶ 5 (1997) (“Ameritech Michigan Order”).

the Federal Communications Commission, and the Eighth Circuit have all found that Ameritech *must* provide shared transport to CLECs.<sup>4/</sup>

Ameritech has been obstructionist on many other issues critical to fostering local exchange competition as well. In Illinois, Ameritech steadfastly refused to pay reciprocal compensation for local calls originated by end users on Ameritech Illinois' network and terminated to ISPs, even though Ameritech's interconnection agreements with certain CLECs "unambiguously" required payment. *Teleport Communications Group, Inc. v. Illinois Bell Telephone Co. Ameritech Illinois*, Nos. 9700404 et al, *see* 1998 Ill. PUC Lexis 161 (March 11, 1998). Several CLECs, including MCI and WorldCom, were forced to file complaints with the Illinois Commerce Commission in order to get compliance with these provisions of their interconnection agreements; the Commission found that "Ameritech Illinois' unilateral 'remedy' [of refusing to pay] . . . lends substantial credence to the complainants' allegations that Ameritech Illinois' conduct is intentionally anticompetitive." *Id* at \*31.<sup>5/</sup>

Ameritech has also engaged in unlawful, anticompetitive behavior in its region by attempting to dissuade customers from changing from Ameritech to competing carriers when the customer seeks to effect the switch during a three-way conference call involving the customer, the

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<sup>4/</sup> See *In the matter, on the Commission's own motion, to consider the total service long run incremental costs and to determine the prices of unbundled network elements, interconnection services, resold services, and basic local exchange services for Ameritech Michigan*, Case No. U-11280, 1998 Mich. PSC LEXIS 46, 183 P.U.R.4th 1 (Mich. Pub. Serv. Comm'n Jan. 28, 1998); *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 F.C.C.R. 12460 (1997); *Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir. 1997), cert. granted, 118 S. Ct. 879 (1998).

<sup>5/</sup> Only in the past few weeks, after seven more months of wasteful legal maneuvering by Ameritech, has Ameritech begun to pay MCI WorldCom the millions of dollars MCI WorldCom is owed in reciprocal compensation.

competitor, and Ameritech. In Michigan and Illinois, the three-way conference calls were mandated by the state commissions to ensure that customers could efficiently and promptly change their presubscribed toll carrier notwithstanding Ameritech's so-called "PIC protection" program designed to lock customers into Ameritech's service just before implementation of intraLATA toll dialing parity.<sup>6/</sup> The Michigan Public Service Commission found "repeated wrongdoing by Ameritech Michigan" in seeking to use these three-way calls as a vehicle for retaining customers instead of for their intended purpose of verifying PIC changes.<sup>7/</sup> Similarly, the Illinois Commerce Commission found that Ameritech's marketing of its own services during these three-way conference calls "impedes the ability of carriers like MCI to fairly and efficiently compete" and that "[t]he cumulative effect of the conduct is to make switching to a competitive carrier via a three way call an unpleasant and difficult experience."<sup>8/</sup> By its own actions, Ameritech has shown that it will do everything it can to inhibit competition in its monopoly regions.<sup>9/</sup>

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<sup>6/</sup> See *Sprint Communications Company, L.P. v. Ameritech Michigan*, Case No. U-11038, 1996 Mich. PSC LEXIS 259, 171 P.U.R.4th 429 (Mich. Pub. Serv. Comm'n Aug. 1, 1996); Illinois Commerce Commission, *MCI Telecommunications Corp. AT&T Communications of Illinois, Inc. and LCI International Telecom Corp. v. Illinois Bell Telephone Co. d/b/a Ameritech Illinois; Sprint Communications Co. L.P. v. Illinois Bell Telephone Co.*, Docket No. 96-0075, 96-0084 (consol.) 1996 Ill. PUC LEXIS 205 (Ill. Commerce Comm'n Apr. 3, 1996).

<sup>7/</sup> *In re the complaint of MCI Telecommunications Corporation against Ameritech Michigan*, Case No. U-11550, 1998 Mich. PSC LEXIS 134, 186 P.U.R.4th 4 (Mich. Pub. Serv. Comm'n May 11, 1998).

<sup>8/</sup> *MCI Telecommunications Corp. v. Illinois Bell Telephone Co., d/b/a Ameritech Illinois Complaint pursuant to Sections 13-514 and 13-515 of the Illinois Public Utilities Act and request for injunction*, Docket No. 97-0540, 1997 Ill. PUC LEXIS 914 (Ill. Commerce Comm'n Dec. 17, 1997).

<sup>9/</sup> Ameritech provided in-region long-distance services without first obtaining section 271 authority, thereby attempting to nullify the incentive created by section 271 for BOCs to open up their local markets. See *In re AT&T Corporation v. Ameritech Corporation, et al.*, Memorandum Opinion and Order, File Nos. E-98-41 et al., FCC 98-242 (rel. Oct. 7, 1998).

As for SBC, it baldly tells the Commission that it has “lived up to the commitments and promises it made related to the SBC-PacTel merger and this positive track record bodes well for the commitments and promises SBC has made regarding the SBC-Ameritech merger.” Affidavit of James S. Kahan ¶ 103 (attached to SBC-AIT Appl.) (“Kahan Aff.”). SBC urges the Commission to “look at the facts.” *Id.* ¶ 93.

MCI WorldCom agrees that this application requires the Commission to “look at the facts” in SBC’s states. MCI WorldCom is all too well aware of those facts and their consequences — and so is the California Public Utility Commission (“CPUC”). On October 5, 1998, following a five-week collaborative process, the CPUC staff issued its final report on SBC-Pacific Bell’s eligibility for section 271 authority in California. The CPUC found, among other things, that:

- “Pacific has complied with four of the 14 checklist items;”
- “Pacific has not opened its market to an extent that allows CLECs a reasonable expectation of serving the mass market;”
- “Pacific proposes a process for combining network elements that is labor intensive at best and completely infeasible at worst;”
- “Pacific has not demonstrated that it has in place a workable method for CLECs to order and provision combined elements;”
- “Pacific does not yet have Operations Support Systems (OSS) in place for network elements that afford CLECs a meaningful opportunity to compete;” and
- “Pacific often chooses solutions based on Pacific’s determination of whether it complies with Section 271 requirements, not based on how effective they might be in promoting competition.”<sup>10/</sup>

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<sup>10/</sup> *Pacific Bell (U 1001 C) and Pacific Bell Communications Notice of Intent to File Section 271 Applications for InterLATA Authority in California* (California Public Utilities Commission Telecommunications Division Final Staff Report, at 5-8, Oct. 5, 1998) (“CPUC Final Staff Report”). A copy of the Report is available over the Internet at [http://www.cpuc.ca.gov/divisions/telecom/final\\_report/table\\_of\\_contents.htm](http://www.cpuc.ca.gov/divisions/telecom/final_report/table_of_contents.htm).

These are the facts in California. SBC has not kept its promises.

Much of SBC's obstructionist conduct in California occurred because "Pacific treats CLECs as competitors rather than as wholesale customers."<sup>11/</sup> The Texas Public Utility Commission found that SBC exhibits the same anticompetitive corporate attitude in Texas. In issuing a recommendation that SBC has not met the requirements of section 271 in Texas, the Texas Commission observed, "SWBT needs to show this Commission and participants during the collaborative process by its actions that its corporate attitude has changed and that it has begun to treat CLECs like its customers."<sup>12/</sup> Approval of this merger will mean that CLECs will face SBC's aggressively anticompetitive "corporate attitude" in one-third of the country.<sup>13/</sup>

Video services provide another example contradicting SBC's claim of a "positive track record" in prior acquisitions. When SBC announced its takeover of Pacific Bell in April 1996, its Chairman said that PacTel's deployment of MMDS video service would continue in California and that the service was a "strategic and economic asset."<sup>14/</sup> Before this Commission, SBC and Pacific "argue[d] that SBC/PacTel will have an increased ability to develop innovative and

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<sup>11/</sup> CPUC Final Staff Report, ¶ 6.

<sup>12/</sup> A copy of the Texas Public Utility Commission's Order is available over the Internet at <http://www.puc.state.tx.us/WHATSNEW/16251de4.htm>.

<sup>13/</sup> Like Ameritech, SBC/Pacific Bell has improperly engaged in anticompetitive efforts to retain customers who want to switch their local telephone service to MCI WorldCom by placing "retention" to these customers. The practice in California was so widespread and destructive that MCI was forced to file a complaint with the Commission. *See MCI Telecommunications Corporation v. Pacific Bell* File No. E-97, Complaint (FCC filed January 28, 1997). The Complaint is still pending.

<sup>14/</sup> Richard Tedesco, "SBC/PacTel deal could unify telco TV," *Broadcasting & Cable*, April 8, 1996.



competitively priced services and products in fields such as . . . video services.”<sup>15/</sup>

Notwithstanding these promises, SBC shut down Pacific Bell’s video services operations within months of the April 1997 closing, selling off Pacific Bell’s wireless cable operation by August 1997 and terminating its wired video projects by November 1997.<sup>16/</sup> According to SBC itself, its “track record” in California is indicative of what it will do after it acquires Ameritech, which also has substantial video operations that do not appear to fit into SBC’s business plan.

With local competition in its infancy, the risks from a merger of this size between regional monopolists that, independent of one another, have behaved so poorly in the past cannot be overestimated. The sheer size and reach of a mega-BOC like SBC-Ameritech-SNET-PacBell would give the combined entity enormous power to block competition for local exchange service. Permitting SBC and Ameritech to merge is simply a mandate to continue in a coordinated fashion the tactics of the past, through an entity that will exercise monopoly control over one out of every three access lines in this country.

**B. SBC’s and Ameritech’s “national local” strategy is a ruse to maintain and consolidate their existing monopoly control over one-third of the nation’s local telephone business.**

SBC and Ameritech unabashedly tell the Commission that this extraordinary consolidation of two powerful monopolists in contiguous regions of the country is necessary so that these two companies can bring competition to out-of-region local exchange markets and fulfill the promise of the Telecommunications Act of 1996. They have couched the merger in “do or die” terms for

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<sup>15/</sup> *In re Applications of Pacific Telesis Group and SBC Communications, Inc. For Consent to Transfer Control of Pacific Telesis Group and Its Subsidiaries*, Memorandum Opinion and Order, 12 F.C.C.R. 2624, ¶ 70 (1997).

<sup>16/</sup> *See* SBC Communications Posts Loss on \$1.6-billion Restructuring Charge, *Communications Daily*, Aug. 1, 1997; “PacBell Bailing out of Cable TV Business,” *Media Daily*, Nov. 17, 1997.

the future of the two companies that must, they say, implement a “national local” strategy in order to remain competitive both inside and outside of their regions. SBC-AIT Appl. at 1, 4-6, 50.

When the details of this “national local” strategy are examined, however, it becomes apparent that it is not at all a plan to bring local competition to out-of-region local markets. Instead, it is a strategy to take advantage of the current *lack* of local competition in order to raise even higher barriers to local entry and lock up a critical group of local customers — large business customers that account for a disproportionate share of all local traffic, revenues, and profits and that have multiple locations concentrated in SBC’s and/or Ameritech’s current regions. SBC and Ameritech do not have a plan to compete for “national local” service at all; they have a strategy to monopolize “regional local” service. Their goal is to preempt local competition within their regions, not to promote it outside them.

SBC and Ameritech have made clear to the Commission that the first and most important component of their plan is to address the telecommunications needs of “224 Fortune 500 companies that are headquartered in the 13 states served by SBC, Ameritech, and SNET.” Kahan Aff. ¶ 49. SBC and Ameritech intend to secure these customers as “anchor tenants” by taking advantage of “first mover advantages” to offer both in-region and out-of-region local service. SBC-AIT Appl. at 5, 13. Notably, their plan is *not* to concentrate on the 276 other Fortune 500 companies headquartered outside their region that are now primarily dependent on other ILECs for local service. Thus, as SBC and Ameritech argue, their first imperative will be to solidify their control over this important base of customers “who though small in number represent a very large portion of [SBC-Ameritech’s] revenues.” *Id.*

As a result of the merger, SBC-Ameritech will be able to offer business customers facilities-based local service at all of their locations where SBC-Ameritech is the incumbent with a

ubiquitous network. SBC and Ameritech correctly recognize that there is a demand for “national local” or “regional local” service: some large businesses that have multiple locations prefer to purchase local and long-distance service from a single source. SBC-AIT Appl. at 15. Equally important, they will “rely heavily” on their own facilities because carriers that are able to meet this demand using their own facilities will have a significant competitive advantage. *Id.* at 15; Kahan Aff. ¶ 30 (“large customers seek services . . . that can only be provided by a company that has facilities-based capabilities across the United States . . .”). These sophisticated business customers understand that a CLEC that is dependent on a competing ILEC for critical inputs will not be able to assure as high-quality and reliable service as it could if it is exclusively facilities-based. The higher the percentage of locations of a multi-location customer to which a LEC is able to provide local services exclusively over its own facilities, the greater its competitive advantage.

The merger enables SBC and Ameritech to meet this demand for facilities-based national service not, as CLECs do, by investment alone, but by consolidating their ubiquitous monopoly networks. SBC-Ameritech’s advantage would be especially great in marketing to customers with all or most of their locations in the SBC-Ameritech region, and that category is likely to include companies headquartered in the SBC-Ameritech region, where decisions concerning the telecommunications needs of a particular company are typically made. The fact that a third of all the nation’s lines are in SBC’s and Ameritech’s regions virtually guarantees the combined company a disproportionate advantage. To the extent that customers headquartered in its combined region have locations distributed more evenly throughout the United States, SBC-Ameritech still could offer, and SBC and Ameritech individually already do offer, facilities-based service at one-third of their locations. Baseman-Kelley Decl. ¶ 86. Because a smaller portion of

the country will be out-of-region after the proposed merger, the amount of investment needed to achieve control over the facilities used to serve any given percentage of locations is smaller for the merged firm than for each firm alone. *Id.* ¶ 58.

Of course, the amount of investment that SBC-Ameritech would need to serve all or most of the out-of-region locations of large businesses headquartered in its region will be substantially less than the investment required by CLECs to provide facilities-based local service to these customers at all of their in-region and out-of-region locations. Baseman-Kelley Decl. ¶ 87. Given the limited geographic reach of CLEC networks even in markets where they have facilities, these networks may not serve even all of the locations of these companies in those markets where CLECs have a presence. By combining the monopoly facilities that serve a high percentage of these locations, the merger would reduce SBC-Ameritech's dependence on gaining affordable and nondiscriminatory recourse to access and resale services from out-of-region ILECs. However, the dependence of CLECs on out-of-region ILECs will be undiminished, and their dependence on SBC and Ameritech in multiple locations would be increased by the merger.

An example using the kind of customer that SBC and Ameritech will target with their "national local" strategy illustrates this point. Take a large business customer headquartered in SBC's region with 50% of its locations there, 20% in Ameritech's region, and 30% in out-of-region locations. Before the merger, in order to serve all of this customer's locations, SBC would need to either build facilities and/or rely on the dominant ILEC in the 50% of the customer's locations outside SBC's territory. Of course, building out its own facilities to all of these locations would necessarily take time, so SBC would serve some of those locations through UNEs or resale from the ILEC that historically served that location. But, the day the proposed merger closes, SBC-Ameritech will be able to provide exclusively facilities-based service to 70%

of the locations, and the percentage of locations that it will use UNEs or resold service to serve will be proportionately reduced. A competing CLEC, however, will likely not be able to offer exclusively facilities-based services to all the locations, inside or outside SBC-Ameritech's combined region, because it takes so much time and money to build local networks as ubiquitous as those of the ILECs. Thus CLECs would have to rely on the dominant ILEC to provide service to more locations than will be true for SBC-Ameritech. Baseman-Kelley Decl. ¶ 87. Solely by virtue of the merger, SBC-Ameritech will have given itself an artificial advantage in providing facilities-based service that will make it even more difficult for meaningful competition to take root for these customers in its combined region.

The end result is that the merger would make it harder for CLECs to compete with SBC-Ameritech to provide facilities-based local service at all or most of the locations of businesses headquartered in SBC-Ameritech's region. A CLEC that seeks to compete with SBC-Ameritech for "national local" business must convince a large business customer to change its local provider in 100% of its locations or convince the customer to use multiple providers. On the other hand, in many cases SBC-Ameritech will already be serving all or most of the customer's locations as a result of its geographic reach and monopoly control over one-third of the lines in the country, and therefore little to no change in providers will be required.

Thus, the true impact of the merger to SBC and Ameritech is that it will significantly increase the percentage of locations of national or, more likely, regional businesses that SBC and Ameritech *already* serve using their own monopoly local facilities. Without any out-of-region investment, SBC and Ameritech will make themselves the primary facilities-based provider of these customers' company-wide needs for local telephone service. Any advantage in serving these customers is important because these "regional local" customers generate a disproportionate

share of local exchange and exchange access revenues and profits — which is precisely why SBC and Ameritech are targeting them. Although SBC does not provide figures for so-called “national local” customers, SBC states that 1% of its business customers represent 18% of its total business revenues. SBC-AIT Appl. at 14.

By focusing on the 224 Fortune 500 companies headquartered in its combined region, and not the 276 Fortune 500 companies based outside their region (much less all the smaller customers), SBC and Ameritech are seeking to leverage their overwhelming monopoly control of facilities in their own regions to lock up these customers once and for all. SBC and Ameritech do not intend to be simply the “first mover” in providing “regional local” service to their largest customers. SBC-AIT Appl. at 5. The merged entity in fact has designs to be the first *and last* mover in providing regional local service (including bundled long distance service) to almost half of the nation’s Fortune 500 companies. Far from promoting competition that purportedly would otherwise not take place in out-of-region markets, SBC-Ameritech’s “regional local” strategy stifles competition for these same kinds of customers within its regions. The fuzzy promise of out-of-region competition is the headline, but consolidation of control over customers within its own region is the story of this merger.

By making it harder for CLECs to compete for large business customers, the merger will decrease competition not only for these customers but for *all* local customers. MCI WorldCom’s goal, like that of many CLECs, is to compete not only for the local business of large business customers, but also for the business of residential and small business consumers. Many CLEC local facilities support service to both large and small customers, and if CLECs’ ability to compete for key business customers is artificially reduced by the proposed merger, the economic justification for investments in facilities that serve all types of customers will be undermined.

Shrinking the available market for CLECs by locking up key business customers will increase barriers to entry into the market as a whole and decrease the ability of a CLEC to compete for *any* customer within the combined region. Baseman-Kelley Decl. ¶ 51. SBC and Ameritech claim that all of their current customers will suffer if they cannot compete effectively for multi-location business customers, SBC-AIT Appl. at 42, and if not for SBC and Ameritech, that is true for CLECs. SBC-Ameritech's merger-created competitive advantage will inevitably reduce competition for all types of customers in local markets throughout their regions.<sup>17/</sup>

**C. The merger increases the potential for coordinated interaction among the few remaining BOCs in the post-merger market.**

As the Commission has found, “[m]arket performance can also be adversely affected if a merger increases the potential for coordinated interaction by firms remaining in the post-merger market.” *BA-NYNEX Order* ¶ 121. Coordinated interaction occurs when a group of firms engages in conduct that is profitable to each of them because of the accommodating reactions of all the others. *Id.* The probability of coordinated interaction increases as “the number of most significant market participants decreases” because “the remaining firms are increasingly able to arrive at mutually beneficial market equilibria, to the detriment of consumers.” *Id.* Coordinated interaction can be accomplished more easily with fewer firms because the remaining firms will

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<sup>17/</sup> The problem would be compounded if SBC and Ameritech were allowed to provide in-region long-distance services while they continue to monopolize local exchange and exchange access services. Baseman-Kelley Decl. ¶¶ 40-48. The profitability of CLEC entry into local exchange service is significantly affected by the ability to compete to provide exchange access. *Id.* If SBC-Ameritech gains a significant share of in-region long distance traffic by executing its “national local” strategy and locking up major business customers that constitute a critical portion of the total local customer base, the market available to CLECs would shrink significantly because SBC-Ameritech's long-distance customers would likely buy access from it, not from CLECs. A contracted market will make it harder for CLECs to justify investment in wide-scale local networks, and that could mean less competition, or delayed competition, for all classes of customers. *Id.* ¶ 51.

cheat on each other less (because they have less incentive to do so as there are fewer customers to win), are able to detect deviations from coordinated conduct more easily, and can effectively punish deviation through coordinated retaliation. *Id.*

The proposed SBC-Ameritech merger alone would significantly increase the likelihood of coordinated interaction. It will make it much easier and more likely for the few remaining major ILECs to continue the non-aggression pact under which they do not compete in each other's regions. Baseman-Kelley Decl. ¶ 9.

All of these effects would be compounded if the Commission permitted both the SBC-Ameritech and the Bell Atlantic-GTE mergers to proceed. Baseman-Kelley Decl. ¶ 26. Indeed, approving the pending SBC-Ameritech merger along with the pending Bell Atlantic-GTE merger would be tantamount to carving most of the United States into two huge regions each controlled by a single monopolist — SBC-Ameritech-SNET-PacBell primarily in the Midwest, Southwest, and West, and Bell Atlantic-GTE-NYNEX primarily in the East. The two combined entities would control almost 70 percent of local exchange revenues in the United States. *Id.* ¶¶ 26-29. The mergers would put two-thirds of the country's access lines into the hands of two monopolists who have steadfastly resisted at every turn any progress toward local exchange competition in this country over the past 2½ years. These two monopolists would together dominate the provision of local telephone service in this country, and possibly dominate bundled local and long-distance service as well in their respective regions — which is precisely the intent of SBC and Ameritech's "national local" strategy.

If the two pending mega-mergers were allowed to proceed, it would be easier for the few remaining ILECs to reach mutually beneficial understandings to limit competition by serving out-of-region locations only of customers predominantly located in their region. For example, SBC-



Ameritech would concentrate on the large business customers headquartered in its region, and Bell Atlantic-GTE would concentrate on the large business customers headquartered in its region. The two proposed mega-BOC mergers together threaten to carve up the United States primarily between two local exchange monopolies of relatively equal size, and it is highly unlikely that either of these two mega-BOCs would have an incentive to compete for customers that are primarily located in the other one's region. The mergers would reduce the likelihood that out-of-region competition by one company would cause the other to respond, and by not responding, both companies would be better off than they would otherwise be. Baseman-Kelley Decl. ¶¶ 68-73. A tacit understanding whereby the two mega-BOCs focus only on businesses located primarily in their particular region would be the likely outcome. And even in the unlikely event that the two mega-BOCs chose to compete at the margins against one another at some indeterminate time in the future, this still would not counterbalance the enormous anti-competitive effects felt in each of their regions now as a result of allowing them to merge in the first instance.

**D. The ability of the Commission – and market competitors – to benchmark the performance and actions of the ILECs would be destroyed if BOC consolidation through mergers continues.**

In the *BA-NYNEX Order*, the Commission carefully analyzed the importance of benchmarking to its ability to combat abuse of market power in the local exchange market, and concluded that mergers of major ILECs seriously threatened the ability to benchmark. *See BA-NYNEX Order* ¶¶ 147-156.<sup>18/</sup> Although the Commission allowed the BA-NYNEX merger notwithstanding this prospect, the pending SBC-Ameritech merger crosses the line.

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<sup>18/</sup> “Benchmarking is the review of performance data from several entities and use of the ‘best’ performance as the principal criterion for comparing entity performance.” *In re Policy and Rules Concerning Rates for Dominant Carriers*, Memorandum Opinion and Order, 12 F.C.C.R. 8115, ¶ 57 (1997).

The importance of benchmarking is beyond dispute. Benchmarking allows the Commission “to ensure just and reasonable rates, constrain market power, [and] establish and enforce the pro-competition rules necessary to achieve competition and deregulation.” *BA-NYNEX Order* ¶ 156. The Commission uses benchmarking in a wide variety of contexts.<sup>19/</sup> As the Commission has recognized, the use of benchmarking is broadly recognized and embraced, even by the parties now before the Commission:

Aside from the DOJ and the courts, the Bell Companies themselves have emphasized the importance of benchmarks, and especially seven benchmarks, as an important regulatory tool. Ameritech stated: “No amount of sophistry can suppress the importance of benchmarks” and that “division of the local exchange networks among seven independent companies has greatly enhanced the detectability of any monopoly abuse and the effectiveness of regulation. Anticompetitive conduct was far less detectible in the predivestiture era . . .” . . . Southwestern Bell stated that seven benchmarks provide “an effective deterrent against even subtle attempts to abuse any advantage which might arise from the ownership of local exchange communications facilities.”

*BA-NYNEX Order* ¶ 149 (citations omitted).

In allowing the Bell Atlantic-NYNEX merger, the Commission decided that reducing the number of BOCs by one from six to five would not “sufficiently impair” the Commission’s

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<sup>19/</sup> The Commission, for example, relied on benchmarking to assess the reasonableness of individual LECs’ physical collocation tariffs. *See In re Local Exchange Carriers’ Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, Second Report and Order, 12 F.C.C.R. 18730, ¶¶ 143, 146 (1997). Similarly, the Commission has termed benchmarking “not only desirable but indispensable” in price cap regulation. *See In re Policy and Rules Concerning Rates for Dominant Carriers*, Memorandum Opinion and Order, 8 F.C.C.R. 7474, ¶ 8 (1993). As the Commission has noted, benchmarking has been a “primary goal” of certain of the Commission’s regulatory efforts. *In re Policy and Rules Concerning Rates for Dominant Carriers*, Memorandum Opinion and Order, 12 F.C.C.R. 8115, ¶ 57 (1997).

benchmarking ability to warrant a blocking of the merger. *Id.* ¶ 156.<sup>20/</sup> But the Commission expressly cautioned against further consolidation:

Further reductions . . . become more and more problematic as the potential for coordinated behavior increases and the impact of individual company actions on our aggregate measures of the industry's performance grows. . . . [A]lthough we do not find the reduction in major incumbent LECs caused by the proposed [Bell Atlantic-NYNEX] merger sufficient to render it against the public interest, further reductions in the number of Bell Companies or comparable incumbent LECs would present serious public interest concerns.

*Id.*

To say that “further reductions” from that post-*BA-NYNEX* landscape are at hand is an understatement. The Commission now faces wholesale consolidation among the incumbent LECs. After consuming Pacific, SBC is proposing to consume both SNET and Ameritech. Having eliminated NYNEX, Bell Atlantic now plans to eliminate GTE as an independent ILEC. Of the nine largest ILECs when the 1996 Act was passed — and of the seven remaining after the *BA-NYNEX Order* — only four BOCs would remain if this round of consolidation is allowed to proceed.

Even without the proposed Bell Atlantic-GTE merger, the SBC-Ameritech merger would significantly reduce the Commission's ability to meaningfully benchmark the performance of the ILECs. Simply put, there would be too few incumbent LECs left to provide meaningful comparisons. *See* Baseman-Kelley Decl. ¶¶ 36-39. Moreover, the sheer size of a SBC-PacBell-SNET-Ameritech conglomerate alone would reduce the value of certain of the Commission's

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<sup>20/</sup> In the *Bell Atlantic-NYNEX* case, the merging parties reassured the Commission that it would still be able to benchmark because there would remain, along with smaller independents, “5 RBOCS, GTE, [and] SNET.” *Id.* ¶ 155 (citation omitted).

benchmarking calculations. *See BA-NYNEX* ¶ 150 (discussing impact of size of ILEC on “X Factor” calculation).<sup>21/</sup>

Beyond the need for benchmarking by the Commission and state regulators, customers and competitors of the ILECs also heavily rely on the ability to compare and benchmark the offers and actions of the LECs. *See* Joint Declaration of Michael A. Beach and Therese K. Fauerbach, ¶ 19 (attached as Ex. 2) (“Beach-Fauerbach Decl.”); Baseman-Kelley Decl. ¶ 38. If in business negotiations an ILEC asserts that a particular service is not feasible or must be structured or priced in a particular manner, a customer (or competitor) can point to the contrary position of a different ILEC to demonstrate that a more reasonable approach is possible. *Id.* As the number of major ILECs is reduced from 9, 8, or 7 down to 4, 3, or even 2, the ability to compare and contrast service offerings will be greatly diminished. This day-to-day benchmarking occurs all the time, and is gravely threatened by the merger proposals now pending before the Commission.<sup>22/</sup>

Benchmarking — by regulators, customers, and competitors — is at least as important in the area of local competition as in other contexts. Today, ILECs engage in a wide variety of abusive practices intended to preclude local competition, but different ILECs use different

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<sup>21/</sup> The size of the merged entity would also increase its ability to dominate the standards-setting process and to establish *de facto* standards that advantage itself and disadvantage potential competitors. *See* Baseman-Kelley Decl. ¶ 39. Both incumbent and competitive LECs need standards in order to be able to interconnect their networks reliably and efficiently. An ILEC like SBC-Ameritech — controlling one-third of the access lines in the country — would have even greater influence in the standards-setting process and, by virtue of its size, would be able to dictate standards that were in its interest. This distortion of the standards setting process would, in turn, further compromise the Commission's ability to benchmark the actions and offerings of the different ILECs.

<sup>22/</sup> Indeed, in its application SBC touts a clear example of a customer benchmarking the performance of differing ILECs. *See* Affidavit of Wharton B. Rivers, Jr., at 8-9 (describing AT&T pressuring one BOC to adopt the more efficient procedures of another BOC) *see* Baseman-Kelley Decl. ¶ 38. This diversity would be diminished in a merger.

anticompetitive tactics. The current number of remaining ILECs gives the Commission and state commissions at least some reasonable opportunity to assess differing positions on issues both large and small — and to select the approach that best advances the goals of competition.

For example, one key area where SBC and Ameritech differ is with the willingness to provide “shared transport.” As the Commission is aware, Ameritech has failed (and continues to fail) to provide shared transport to CLECs. *See Ameritech Michigan Order* ¶¶ 298-318. In stark contrast to Ameritech's prior and continuing refusal to provide shared transport, SBC to date has provided shared transport on a reasonable (albeit not perfect) basis. *See Beach-Fauerbach Decl.* ¶ 8.

Other differences, large and small, are commonplace. One recent example involves the Commission's proposal for performance measurements for ILEC provisioning of unbundled network elements and resold local service.<sup>23/</sup> Although all of the ILECs submitted general comments on the proposal, SBC and Ameritech each responded to specific measurements proposed by the Commission. In their separate responses, SBC and Ameritech provided differing and conflicting views of the reasonableness, feasibility, and practicality of different measures. For example, Ameritech objected to the Commission's proposal (*Performance Measurement NPRM* ¶ 78) that ILECs disclose the percentage of accurate E911 database updates, but SBC essentially accepted the proposal. *Compare Ameritech's Initial Comments in Response to Notice of Proposed Rulemaking*, at 49-50 (“Ameritech Comments”) *with* *Comments of SBC Communications, Inc.*, at 13 (“SBC Comments”). In contrast, Ameritech did not object to the Commission's proposal (*Performance Measurement NPRM* ¶ 85) that ILECs provide the

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<sup>23/</sup> See *In re Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance*, Notice of Proposed Rulemaking, 13 F.C.C.R. 12817 (1998) (“*Performance Measurement NPRM*”).

percentage of customer troubles resolved within the estimate time, while SBC did object and proposed a different approach to the issue. *Compare* Ameritech Comments at 60 *with* SBC Comments at 14. Whatever the merits of any particular objection raised by Ameritech or SBC, the fact that the Commission received an array of responses gives it greater flexibility to craft a coherent approach that promotes competition.<sup>24/</sup>

Another significant area of difference between SBC and Ameritech involves combinations of unbundled network elements (“UNEs”). Ameritech has consistently refused to combine UNEs or to provide on a combined basis network elements that exist in their network in combined form. *See* Beach-Fauerbach Decl. ¶ 9. SBC, in contrast, stated its willingness to continue to provide combinations after the Eighth Circuit struck down regulations requiring UNE combinations. *See id.* ¶ 10.<sup>25/</sup>

Directory assistance data provides another example. MCI and Ameritech recently negotiated an agreement under which Ameritech will provide to MCI directory assistance data in bulk format, instead of on a “listing-by-listing” basis), but SBC vigorously resisted providing bulk data as a UNE on a nondiscriminatory basis. *See* Beach-Fauerbach Decl. ¶¶ 14-15.<sup>26/</sup>

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<sup>24/</sup> Similar opportunities for benchmarking arise in other contexts. For example, in one section 271 proceeding, SBC provided detailed performance measurement results beyond anything then required by the Commission. *See In re Application of SBC Communications, Inc., et al., for Provision of In-Region InterLATA Services in Oklahoma*, CC Docket No. 97-121 Ex parte of June 30, 1998.

<sup>25/</sup> *See Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir., 1997), cert granted 118 S.Ct. 879 (1998); Petition of MFS Communication Co., Inc. for Arbitration of Pricing of Unbundled Loop, Amendment and Clarification of Arbitration Award, at 4, Docket 16189 *et al.* (Tex. Pub. Util. Comm’n Nov. 24, 1997) (“*Texas PUC Combination Order*”). SBC later attempted to renege in Texas on its agreement to provide combinations, but the Texas Public Utility Commission held SBC to its initial commitment. *See Texas PUC Combination Order*. SBC appealed that ruling to federal district court pursuant to section 252(e)(6).

<sup>26/</sup> MCI was forced to litigate the issue and eventually prevailed in arbitration. *See* Arbitration Award, *Petition of MCI Telecommunications Corporation for Arbitration of*

The merger would destroy the existing diversity of approaches to important competitive issues affecting competition. Given the ILECs' interest in preventing effective local competition from emerging, the likely result of the proposed merger is that customers and competitors such as MCI WorldCom would be left with the worst of both companies' policies and practices. This is exactly what happened following SBC's acquisition of Pacific Bell. For example, prior to that merger Pacific Bell used a billing format that was designed for carrier-to-carrier transactions for billing on services that MCI obtained from Pacific Bell. Following the merger and at the behest of SBC, Pacific Bell unilaterally substituted another billing format that SBC uses for *retail* sales — a format significantly less useful to another carrier. *See* Beach-Fauerbach Decl. ¶¶ 11-13.

It is therefore entirely predictable, for example, that if the merger is approved, Ameritech will adopt SBC's anticompetitive position denying access to UNEs unless CLECs first obtain licenses or right-to-use agreements from each and every vendor who SBC claims may have intellectual property embedded in the UNE.<sup>27/</sup>

If the proposed merger were permitted, the Commission would lose an important tool used to nurture local competition and control the abuse of monopoly power. Customers and competitors such as MCI WorldCom would lose the ability to compare the performance of different ILECs. The few remaining major ILECs would be all the more able to exclude competition and abuse their dominant position in the local exchange market.<sup>28/</sup>

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*Directory Assistance Listings Issues under Federal Telecommunications Act of 1996*, Docket No. 19075 (Pub. Util. Comm. of Texas) (rel. Sept. 15, 1998).

<sup>27/</sup> *See* Beach-Fauerbach Decl. ¶¶ 16-17; MCI's Petition for Declaratory Ruling, *In the Matter of Petition of MCI for Declaratory Ruling that New Entrants Need Not Obtain Separate License or Right-to-Use Agreements Before Purchasing Unbundled Network Elements*, CC Docket 96-98 (filed Mar. 11, 1997).

<sup>28/</sup> Continued consolidation of ILECs if all pending and likely future proposed mergers are approved would make benchmarking totally impossible, just as it was with the old Bell System

**E. The merger would increase SBC's and Ameritech's ability to exercise market power over interLATA telecommunications services if they obtain section 271 authority while their bottleneck remains intact.**

Another significant threat to competition posed by this merger involves the long distance market if SBC and Ameritech gain authority under section 271 to provide interLATA telecommunications services within their regions while they continue to possess bottleneck control over local exchange and exchange access services. In these circumstances, the merger likely would facilitate SBC-Ameritech's ability to achieve significant market power in the market for long distance telecommunications services. Baseman-Kelley Decl. ¶¶ 40-53.

The proposed merger would enhance SBC and Ameritech's ability to engage in anticompetitive price squeezes because it would enable them to engage in price discrimination on both ends of more calls. The Commission has recognized that BOCs have the ability to undermine competition by "squeezing" the differential between the price of interstate exchange access services purchased by competitors and the retail price of long distance service offered by the ILEC to its customers. See *BA-NYNEX Order* ¶¶ 115-117. The price squeeze is accomplished by setting a "high" price for access services and a "low" price for retail long distance services. Baseman-Kelley Decl. ¶¶ 41-42. By expanding SBC and Ameritech's regions, the merger would cause a higher percentage of calls to both originate and terminate in-region.<sup>29/</sup> SBC-Ameritech's artificial advantage resulting from inflated access charges is greater for calls that begin and end within its region. By using its own ubiquitous facilities for access within its expanded region, SBC-Ameritech would get access at its economic cost at both the originating

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when all of the BOCs were under common ownership.

<sup>29/</sup> This effect is increased by the fact that SBC's and Ameritech's regions are geographically contiguous to the extent that people are more likely to make long-distance calls to locations that are closer than to locations that are farther away.



and terminating ends (notwithstanding any nominal internal transfer price), but unaffiliated competitors would pay the inflated rate. Baseman-Kelley Decl. ¶ 41. Through a variety of strategies, SBC-Ameritech could undercut the long distance prices of its competitors even though it is no more efficient. *Id.* ¶¶ 46-48.

The Commission concluded that it could approve a merger that facilitated “price-squeezing” tactics if the tactics were addressed by “adequate safeguards against such conduct,” including requiring that “interconnection and unbundled network elements (UNEs) are available at rates based on the economic costs of providing such services and facilities.” *BA-NYNEX Order* ¶ 117. SBC and Ameritech have not carried their burden to prove that interconnection and unbundled network elements are available at economic cost in its region; indeed, the general absence of local exchange access competition within their regions speaks for itself.

The ability to engage in less detectable and more significant non-price discrimination is also significantly enhanced by the merger. Baseman-Kelley Decl. ¶¶ 49-50. Although the Commission did not find that a previous ILEC merger significantly enhanced the likelihood of anticompetitive effects of non-price discrimination by the merging ILECs, *see BA-NYNEX Order* ¶ 120, here the issue involves a much higher concentration of access lines under common ownership — one-third of all access lines in the entire country — than was at issue in the Bell Atlantic-NYNEX merger. Thus, interexchange carriers will be more dependent on a single entity for access exchange than they would be absent the merger. This would make hard-to-detect methods of non-price discrimination even more crippling to competing long-distance companies.

Common ownership facilitates SBC's and Ameritech's ability to focus their non-price discrimination efforts across the two regions.<sup>30/</sup>

**III. THE MERGER WOULD REDUCE LOCAL COMPETITION BY ELIMINATING ENTRY BY SBC AND AMERITECH THAT WOULD OTHERWISE OCCUR INTO EACH OTHER'S MONOPOLY LOCAL MARKETS.**

SBC and Ameritech are each successful companies that can implement with ease, independent of one another, strategies that they argue are vital to their survival. If the two companies together have the resources and interest in competing out-of-region if the merger is approved, each will compete individually if the merger is not approved. The merger therefore would eliminate competition by SBC against Ameritech and by Ameritech against SBC, and competition and consumers will suffer the consequences.

SBC and Ameritech argue that out-of-region competition for national local service is critical to the competitive future of each company because each "can no longer remain as regionally-based providers." SBC-AIT Appl. at 1, 4-6. Taken at their word, SBC and Ameritech

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<sup>30/</sup> The SBC-Ameritech merger increases the risk of harm to long distance competition from another potential anticompetitive practice — "grooming" international traffic inbound to the United States. The Commission recently requested comments on whether grooming arrangements between foreign carriers with market power in their home market and ILECs present a potential for anticompetitive effects and on how that risk could be reduced. *See In re 1998 Biennial Regulatory Review - - Review of the International Settlements Policy and Associated Filing Requirements*, Notice of Proposed Rulemaking, IB Docket No. 98-148, ¶ 43 (rel. Aug. 6, 1998). The Commission should indeed be concerned about grooming arrangements between a dominant foreign carrier and an ILEC. An ILEC's monopoly control over the local access and exchange markets enables it to negotiate more favorable arrangements to terminate U.S. inbound traffic with dominant foreign carriers that increase the cost of competing U.S. carriers. For example, an ILEC may seek to groom inbound traffic geographically to increase the proportion of low-cost traffic it receives from a foreign correspondent, and the result is to shift high-cost traffic to competitors and thereby undermine their ability to compete. The combination of SBC and Ameritech increases the risks and anticompetitive effects because extending their combined monopoly power over an even greater portion of the United States makes the merged entity an even more attractive grooming partner than the two ILECs standing alone.

have the desire to compete out-of-region, whether or not their merger is approved. If the merger is not approved, and if each company pursues its out-of-region strategy, they would compete against each other. The only question is whether, but for the merger, SBC and Ameritech individually would have the financial resources and technical expertise to pursue that strategy on its own.

In attempting to justify the facially anticompetitive nature of this mega-merger between two monopolists, SBC and Ameritech contend that each is too small to make the necessary expenditures in out-of-region facilities in order to execute a national local strategy. SBC-AIT Appl. at 7. SBC and Ameritech state that the merger company will need to make \$2 billion of capital expenditures to compete out-of region. Kahan Aff. ¶ 57. SBC and Ameritech's assertions of poverty cannot be taken seriously.

For new local entrants without a monopoly base, every region is out-of-region, and if CLECs can afford to compete in areas where they do not have a monopoly, then so too can SBC and Ameritech individually. SBC and Ameritech say that an important impetus for their "national local" strategy is that CLECs that are currently pursuing their own "national local" strategy will otherwise capture many of their largest in-region customers. SBC-AIT Appl. at 6; *see id.* at 49. In fact, these CLECs, which are much smaller in revenues and profits, have invested proportionally far more in attempting to enter local exchange markets than SBC-Ameritech is planning to spend. As the Commission has found, the capital markets have been a reliable source of billions of dollars of capital for CLECs seeking to enter the marketplace.<sup>31/</sup> To the extent that

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<sup>31/</sup> See *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Notice of Inquiry, CC Docket No. 98-146, FCC 98-187, ¶ 29 (rel. Aug. 7, 1998).

SBC and Ameritech even need to go to these capital markets, they would be at least as ready a source of financing for SBC or Ameritech if they seek to pursue the same strategy as CLECs.<sup>32/</sup>

SBC and Ameritech confirm that companies much smaller than a combined SBC-Ameritech can afford to compete against entrenched monopolists when they argue that out-of-region local competition from SBC-Ameritech will spur local competition “in the new SBC’s own region as much as elsewhere,” for example, as U S West and CLECs in Denver enter local markets in SBC-Ameritech’s region. SBC-AIT Appl. at 90; *see id.* at 7-8, 24-25, 78-79, 100. If companies significantly smaller than the combined SBC-Ameritech will be large enough to respond to competition from SBC-Ameritech, it clearly follows that SBC or Ameritech, standing alone, will also be big enough to initiate competition on its own — and against each other. Baseman-Kelley Decl. ¶¶ 75-78. SBC and Ameritech cannot have it both ways: they cannot claim that they are too small to compete, but then rely on much smaller companies as examples of who will compete with them after they merge.

In fact, SBC and Ameritech each has financial resources that are more than ample to support the out-of-region strategy on which they say their success depends. Although SBC and Ameritech would have the Commission believe otherwise, there is simply no plausible evidence that SBC and Ameritech face an all-or-nothing choice between competing in all major out-of-region markets if the merger is approved versus competing in none without the merger. The chart

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<sup>32/</sup> SBC and Ameritech claim that the merger will enable them to compete out-of-region with fewer managers. *See* Kahan Aff. ¶¶ 77-78; Carlton Aff. ¶¶ 31-35. But this alleged synergy merely reflects the fact that less of the country will be out-of-region after the merger and therefore fewer managers will be required to oversee out-of-region activities. Baseman-Kelley Decl. ¶ 80. The merger-generated “saving” is a symptom of the underlying problem with the merger, not a rationale for permitting it. *Id.* More generally, SBC and Ameritech fail to demonstrate that any of the alleged efficiencies generated by the merger, most of which do not appear to be related to out-of-region competition, will actually benefit consumers.

below sets forth relevant financial data for SBC, Ameritech, other local exchange monopolists, and competitive carriers. By any objective measure, the ability of SBC and Ameritech independently to finance an out-of-region entry strategy cannot be questioned. The money that each generates from its domestic monopoly dwarfs the resources available to CLECs. SBC and Ameritech themselves characterize MCI WorldCom, Sprint, Bell Atlantic, BellSouth, and GTE as “comparable in size” to the *merged* SBC-Ameritech, and they are at least as comparable to SBC and Ameritech pre-merger. SBC-AIT Appl. at 53 & n.67. Indeed, companies with only a fraction of the cash flow of SBC or Ameritech are already financing aggressive strategies to compete for local exchange service.<sup>33/</sup>

	Revenue (\$millions)	EBIT (\$millions)	Net Income (\$millions)
Company	1997	1997	1997
Ameritech	15,998.0	3,799.0	2,296.0
SBC	24,856.0	3,170.0	1,474.0
Bell Atlantic	30,193.9	5,341.5	2,454.9
Bell South	20,561.0	5,376.0	3,270.0
GTE	23,260.0	5,611.0	2,794.0
U S West	10,319.0	2,210.0	1,180.0
AT&T-TCG	51,813.3	6,835.5	4,349.3
MCI WorldCom	27,004.4	1,773.7	592.7
Sprint	14,873.9	2,451.4	952.5

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<sup>33/</sup> The data in the table is drawn from *QuickSource Fundamental Data & Ratios Reports* (Wall Street Research Net). The most recent financial information available for SBC and Ameritech indicates that their monopoly profits continue to make independent out-of-region entry viable for each company. Today (October 15, 1998), Ameritech reported “record third quarter profits.” See Ameritech Press Release, October 15, 1998 (<http://www.ameritech.com/media/releases/release-1644.html>). SBC had net income for the six months ended June 1998 of \$1.89 billion on revenue of \$13.02 billion. See SBC Press Release, August 3, 1998, RCR Communications Report, at 21.

	Revenue (\$millions)	EBIT (\$millions)	Net Income (\$millions)
Advanced Radio	1.1	(39.1)	(61.7)
Electric Lightwave	61.1	(34.1)	(33.9)
e.spire (ACSI)	59.0	(82.2)	(115.0)
GST	36.3	(21.8)	(39.6)
ICG	273.4	(180.9)	(327.6)
Intermedia	247.9	(163.5)	(197.3)
McLeod USA	267.9	(69.3)	(79.9)
NextLink	57.6	(102.6)	(129.0)
RCN Corp.	127.3	(60.9)	(49.2)
Teligent	3.3	(135.4)	(138.1)
USN Comm.	47.2	(98.0)	(109.9)
Winstar	79.6	(188.1)	(249.5)

SBC's and Ameritech's ability to invest individually in overseas markets also suggests that their plea of poverty with respect to domestic local competition is bogus. SBC and Ameritech have collectively invested in *overseas* out-of-region markets \$11-15 billion, orders of magnitude more than the \$2 billion that they claim they would invest in out-of-region local markets in the United States in order to protect their core local business. *See* SBC-AIT Appl. 16-17, 26 (\$11 billion in foreign investment); Affidavit of Robert Jason Weller ¶ 16 (\$14-15 billion in foreign investment) (submitted with SBC-AIT Appl.). It simply is not credible that a company that can afford to make foreign investments on this scale cannot independently finance domestic strategies that it considers vital to its survival. If investing in Chicago, Detroit, or Cleveland is vital to protect SBC's core business in Dallas, Houston, Los Angeles, and San Francisco, SBC will spend that money in these cities — not only in Paris, Tel Aviv, or Johannesburg. *See* SBC-AIT Appl., Table 15. Similarly, if investing in Dallas, Houston, Los Angeles, and San Francisco is necessary to protect Ameritech's core business in Chicago, Detroit, and Cleveland, Ameritech will invest in these cities — not only in Brussels, Copenhagen, or Budapest. *See id.*

SBC and Ameritech's claim that "neither company, standing alone, has the breadth of experienced management and skilled technical personnel" to compete for local exchange business out-of-region" is ludicrous. *See* SBC-AIT Appl. at 7. Formed from the old Bell System, these companies have been in the local telephone business for a century. These are not neophytes to the local exchange business that must combine their managerial expertise in order to know how to compete in local exchange markets that happen to be out-of-region; these are highly skilled and highly experienced monopolists who have owned local exchange service since the business began. If SBC and Ameritech do not have the expertise to compete out-of-region for local exchange access, who does?<sup>34/</sup>

The merged SBC-Ameritech plans to invest \$2 billion to compete in 30 local markets outside their expanded monopoly region. Kahan Aff., ¶ 57. If each really wanted to do so, either SBC or Ameritech individually could finance facilities-based entry into 30 markets, just as MCI, MFS, and Brooks did individually before their merger to form MCI WorldCom. Even if each company by itself would not enter 30 out-of-region markets, each is likely to enter at least some of the other's monopoly markets. After all, SBC and Ameritech exercise monopoly control over local exchange access in six of the ten largest local exchange markets in the United States. Thus, even if SBC and Ameritech would not compete in as many out-of region markets on a stand-alone basis (which is far from clear), SBC would compete in some out-of region markets that would inevitably include at least some Ameritech cities such as Chicago, Detroit, and Cleveland, and

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<sup>34/</sup> SBC and Ameritech say that they have the personnel and the expertise to compete successfully overseas. SBC-AIT Appl. at 26. If each company individually can succeed in Denmark, Hungary, Israel, Chile, South Korea, and South Africa, *see* SBC-AIT Appl. Table 15, then surely SBC can succeed in Chicago and Detroit, and Ameritech can succeed in Los Angeles and Houston.

Ameritech would compete in some out-of-region markets that would inevitably include at least some SBC cities such as Los Angeles, San Francisco, Dallas, and Houston.

Entry by an existing ILEC into another's territory, even on a somewhat more limited scale, would have dramatic competitive effects. Baseman-Kelley Decl. ¶¶ 31-35. That will be true for SBC and Ameritech because they will "rely heavily" on unbundled network elements, SBC-AIT Appl. at 79, so they will have in interest in ensuring that they are provided efficiently and at cost-based rates. For example, SBC's entry into Cleveland and no other cities in Ohio would benefit local competition throughout Ohio, and for that matter, throughout the entire Ameritech region. If an experienced local exchange carrier like SBC demonstrated that Ameritech could improve its OSS, local competition everywhere in the Ameritech region would benefit because Ameritech uses the same OSS region-wide. Similarly, if SBC showed an efficient LEC could provide unbundled loops at a lower price than Ameritech claimed, the cost-based rate for unbundled loops would drop not only in Cleveland but in all of Ohio because of state-wide pricing. In sum, new entrants would be better able to rebut obstructionist arguments of the incumbent if their ranks included another incumbent.

Equally important, SBC's activities in Ameritech's region would facilitate local competition in *SBC's* region, and Ameritech's activities in SBC's region would facilitate local competition in *Ameritech's*. CLECs would be able to use in SBC's region the arguments that SBC made in the Ameritech region to make UNEs and wholesale services available on better terms, and CLECs would be able to use in Ameritech's region the arguments made by Ameritech to get better terms from SBC. Thus SBC's failure to compete in Ameritech's region impedes competitive entry in SBC's region, and vice versa.<sup>35/</sup>

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<sup>35/</sup> The fact that out-of-region competition may jeopardize their in-region monopolies may explain SBC's and Ameritech's decision not to compete out-of-region to date. However, if SBC



SBC and Ameritech have not carried their burden to demonstrate that neither company individually would compete out-of-region if their application were denied. There is indeed some evidence suggesting that SBC and Ameritech intended to compete against one another for local exchange service absent the merger. According to SBC itself, Ameritech competes against it in Texas to provide local services.<sup>36/</sup> More generally, Ameritech offers to serve as a “global purchasing agent” for local exchange services for large businesses,<sup>37/</sup> so, for example, Ameritech will make the arrangements for customers headquartered in its region to obtain local telephone service in Texas or California. Last year, Ameritech apparently also initiated a wireline local exchange trial in SBC territory in St. Louis.<sup>38/</sup> SBC has at least begun to compete with one other major ILEC — GTE in Texas.<sup>39/</sup>

The details of these forays into head-to head competition are sketchy and are not publicly available. As it did in the context of the Bell Atlantic-NYNEX merger, the Commission should thoroughly investigate explore the actual plans for such competition between SBC and Ameritech

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and Ameritech are willing to take this risk collectively, they would be willing to take it individually.

<sup>36/</sup> See Comments of the Public Utility Commission of Texas, at 2-3 (filed with the FCC Sept. 10, 1998) (noting that SBC had relied on Ameritech as a “viable competitor in the Texas State 271 proceeding”).

<sup>37/</sup> See <http://www.ameritech.com/products/custom/product/gdmla.htm>.

<sup>38/</sup> See *Affidavit of Elizabeth A. Ham* (attached to Brief in Support of Application By Southwestern Bell For Provision of In-Region, InterLATA Services in Texas) (noting that “Ameritech has been testing the EDI Gateway for resale services . . . [and] expects to begin processing end user resale services LSRs in Missouri via the EDI Gateway before the end of February 1998.”).

<sup>39/</sup> See Mark P. Couch, “Competition for local phone customers just a skirmish so far,” Ft. Worth Star Telegram (Oct. 5, 1998). In addition, SBC contemplated competing against Bell Atlantic in Maryland and disputed Bell Atlantic's position in state regulatory proceedings. See Baseman-Kelley Decl. ¶ 33.

in order to evaluate whether the public interest is served by this merger. *BA-NYNEX Order* ¶¶ 58-113. The only way for the Commission to effectively conduct such an inquiry is to require SBC and Ameritech to make available to Commission and to interested parties under a protective order documents relating to their plans, individually and collectively, to compete out-of-region with or without the merger.<sup>40/</sup> As it did with the Bell Atlantic-NYNEX merger, the Commission should require SBC and Ameritech to provide the relevant Hart-Scott-Rodino materials submitted to the Department of Justice in connection with its investigation of the merger. *BA-NYNEX Order* ¶ 28.

As the Commission has recognized, “[i]n telecommunications markets that are virtual monopolies or that are not yet developed, . . . the loss of even one significant market participant can adversely affect the development of competition and the attendant proposals for deregulation.” *BA-NYNEX Order* ¶ 66; Baseman-Kelley ¶ 35. The Commission includes as a significant market participant an ILEC that is reasonably likely to enter another ILEC’s territory. *Id.* ¶¶ 72-73. Because SBC’s and Ameritech’s own statements about the imperative to compete out-of-region suggest that they will compete head to head against one another in at least some markets if they do not merge, and because the competitive pressures on each of them to compete out-of-region are likely to increase as local competition grows, each of the companies should be treated as a likely potential significant market participant in the other’s markets. Baseman-Kelley ¶¶ 70-73. The loss of a potential significant market participant will harm competition for local exchange access in each of the regions because it will “(1) increase firms’ ability to exercise market power unilaterally in the market for local mass market services . . . ; (2) increase firms’

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<sup>40/</sup> The documents would include, at a minimum, documents relating to Ameritech’s activities to compete in Texas, Ameritech’s provision of local service in St. Louis, and, of course, the much ballyhooed national-local strategy that the combined company would allegedly pursue.

ability to exercise market power unilaterally in the market for bundled local and interexchange services . . . ; (3) increase the likelihood that firms will exercise market power through coordinated interaction; and (4) adversely affect the dynamic development of competition in both local and bundled markets . . . .” *BA-NYNEX Order* ¶ 100.

The proposed merger would therefore reduce competition in both regions by eliminating Ameritech as an independent entrant into SBC’s region and SBC as an independent entrant into Ameritech’s region.

**IV. BY SIGNIFICANTLY INCREASING THE PERCENTAGE OF INTERNET USERS AND TRAFFIC OVER WHICH SBC AND AMERITECH WOULD HAVE BOTTLENECK POWER, THE PROPOSED MERGER THREATENS COMPETITION IN INTERNET SERVICES.**

When the Commission reviewed the Bell Atlantic-NYNEX and SBC-Pacific mergers, it did not consider whether the merger would endanger competition among ISPs and threaten higher prices for Internet users and content providers. Since then, in its review of the MCI WorldCom merger, the Commission expressed concern about the potential impact of mergers on the Internet, and the Commission imposed the very substantial condition that MCI divest its entire Internet business before merging with WorldCom. *MCI-WorldCom Order* ¶¶ 142, 227. The threat posed by the SBC-Ameritech merger to the Internet warrants equally serious attention. By consolidating their monopolies and the Internet business each has obtained through anticompetitive conduct, the merger threatens to make the combined SBC-Ameritech such a major factor as an ISP that it can force other ISPs to exchange Internet traffic on unfair terms and gain further power over Internet services. That threat is especially significant because of two recent developments: (1) the emergence of high-speed digital loop services as an important method of Internet access, and the ILECs’ leveraging of their current monopoly over such services to obtain more Internet business; and (2) the ILEC’s on-going efforts to raise the costs of

competing ISPs by extending the current system of excessive access charges to Internet traffic, which also threatens to bias competition in favor of SBC's and Ameritech's ISPs.

An ISP with a large and disproportionate share of Internet traffic from customers that are effectively locked into its service may be able to exercise market power. Internet users, including consumers and content providers, demand that their ISPs provide universal connectivity — the ability to exchange Internet traffic with any other Internet user. When one ISP controls access to a greater percentage of Internet customers than other ISPs, loss of connectivity to the larger ISP may hurt the smaller ISPs more than loss of connectivity to any of the smaller ISPs would hurt the larger ISP. Any resulting inequality in bargaining power may enable the larger ISP to impose a deal in which smaller ISPs pay it more (on a per-unit basis) to terminate their traffic than the larger ISP pays them to terminate its traffic.<sup>41/</sup> As a result, the larger ISP may be able to increase the costs of rivals that are no less efficient or innovative, and the consequence for consumers would be higher prices for Internet services. If the larger ISP becomes big enough and reaches a critical mass, a tipping effect may occur that enables it to wield spiraling power over Internet services. Baseman-Kelley Decl. ¶¶ 102-109.

SBC and Ameritech each operate ISPs.<sup>42/</sup> Their ISPs are growing, and they naturally want their ISPs to grow more and faster. Although SBC and Ameritech gloss over the point in a single paragraph of their application, an important element of the planned business strategy of the

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<sup>41/</sup> Whether in the form of peering arrangements or contracts for purchase of dedicated or dial-up access, agreements between ISPs for the exchange of Internet traffic are unregulated.

<sup>42/</sup> MCI WorldCom believes that these BOCs today are violating section 271 by providing Internet services. Over two years ago, MFS asked the Commission to enforce its previous decisions and find that these are prohibited interLATA information services. Petition of MFS Communications Co. for Reconsideration of Bell Atlantic CEI for Internet Access Service, CCB-Pol 96-09 (filed July 3, 1996). The Commission still has not responded.

combined firm is to create a “nationwide Internet Protocol (“IP”)-based network capable of providing advanced data and Internet access capabilities.” *See* SBC-AIT Appl. at 16.

Not content to compete strictly on the merits of their ISP services, SBC and Ameritech are pursuing two anticompetitive strategies to leverage their local bottleneck power in order to increase their Internet business. *First*, SBC and Ameritech are taking advantage of the popularity of advanced high-speed local services like xDSL to tie their Internet services to their local services. If the promise of these services is realized and they become the predominant form of access to the Internet, these tying arrangements will enable SBC and Ameritech to capture a predominant share of Internet business within their regions. *Second*, SBC and Ameritech are trying to increase the costs of competing ISPs by making them pay exorbitant prices for the calls that they receive from their customers. Even though the cost of completing a call to an ISP is no greater than the cost of any local call, ILECs want ISPs to pay them inflated access charges applicable to interstate calls. Because an ILEC’s ISP (whether integrated with the ILEC or a nominally separate affiliate) will pay only the economic cost of access, it will have an artificial advantage that enables it to capture Internet business even if it is less efficient and less innovative than its competitors.

The merger would combine the Internet traffic of both companies, and the combined company’s ISP may have the critical mass of Internet traffic that permits it to skew Internet competition in its favor. The anticompetitive strategies that SBC and Ameritech are currently pursuing will give them more Internet business than they would earn through fair competition. The merger could therefore enable SBC-Ameritech to increase its Internet business to the point that, either individually or with other mega-BOCs, it could achieve market power, for example, by forcing other ISPs to accept asymmetric interconnection agreements.

**A. SBC-Ameritech could leverage its bottleneck control over local services, especially advanced high-bandwidth services, to acquire enough Internet traffic to exercise market power through coordinated interaction with other mega-BOCs.**

Virtually all traffic between end users and ISPs in their regions must go through the networks of SBC and Ameritech, whether through analog modem dial-up, ISDN, or dedicated access such as T-1s and fractional T-1s. Internet users and content providers in SBC's and Ameritech's regions are almost wholly dependent on reaching the Internet through SBC's and Ameritech's monopoly local networks. Although ISPs that provide Internet connectivity between local networks lack any bottleneck power and compete intensely,<sup>43/</sup> the ILECs exercise bottleneck control of the local Internet connections of end users and content providers. The current lack of local competition leaves Internet users with no choice but to use the ILEC's local network to reach the ISP of the user's choice.

That is true for advanced services like xDSL as well as more traditional methods of access to the Internet. With the advent of advanced high-bandwidth data services such as xDSL that are particularly attractive to Internet users, an ILEC's ability to affect Internet traffic to and from captive customers within its region will become even greater. The Commission has focused on xDSL services because of their potential to make high-speed access to Internet services more

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<sup>43/</sup> No interLATA backbone provider has bottleneck control over any customer. Even a company with 50% of that business would not have anything approaching the kind of control over its customers that any ILEC has over its customers. ISPs and end users can choose among several operators of national backbone networks, *see* SBC-AIT Appl. at 94 (29 national backbone providers), and no ISP or end user is locked into obtaining backbone service from its current provider because all retail and wholesale backbone customers can switch Internet backbone providers with relative ease. *See In re Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211 at 74, 78-80, Joint Reply of WorldCom, Inc. and MCI Communications Corporation to Petitions to Deny and Comments (filed Jan. 26, 1998). The dynamic and flexible nature of the Internet means that any ISP or retail customer of which a provider of long-haul backbone services attempted to take advantage would be able to respond easily and quickly and to find an alternative supplier (if it were not already multi-homed).

broadly and cost-effectively available.<sup>44/</sup> Digital Subscriber Line (“DSL”) technology runs over existing copper telephone wires, and provides transmission speeds dramatically higher than other commonly available options.<sup>45/</sup> Although there has long been the promise of high speed digital access, xDSL services have the potential for widespread deployment at affordable prices that has eluded ISDN and other offerings. In particular, it promises to become a leading option for small and medium businesses and residential consumers that want high-speed Internet access but that would not purchase more expensive high bandwidth services like T-1 service.

Thus, although few consumers are able to utilize xDSL services today (because ILECs, including SBC and Ameritech, have effectively prevented competition to provide them from getting started), these services may become the predominant form of Internet access in the future. If they do become a principal method of Internet access, the ILECs’ current and future bottleneck control over that technology could enable them to inflict harm on competition in the Internet marketplace.

Both SBC and Ameritech currently provide xDSL services to customers, and both “plan a widespread deployment of DSL technology.” SBC-AIT Appl. at 45.<sup>46/</sup> Ameritech claimed last

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<sup>44/</sup> See *In re Inquiry Concerning the Deployment of Advanced Telecommunications Capabilities to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Notice of Inquiry, CC Docket No. 98-146, FCC 98-187 ¶¶ 18-22 (rel. Aug. 7, 1998).

<sup>45/</sup> Background and details concerning xDSL service can be found in *In Re Deployment of Wireline Services Offering Advanced Telecommunications Capabilities*, Memorandum Opinion and Order, and Notice of Proposed Rulemaking, CC Dockets Nos. 98-147 *et al.*, FCC 98-188 (rel. Aug. 7, 1998).

<sup>46/</sup> See <http://public.pacbell.net/dedicated/dsl>; <http://www.ameritech.com/products/data/adsl/index.html>. These World Wide Web pages are attached hereto as part of Exhibit 3.

week to have “launched one of the largest, single commercial deployments” of ADSL service,<sup>47/</sup> and it plans “to pass 70 percent of homes.” SBC-AIT Appl. at 45. In May 1998, SBC announced a “broad geographical rollout” of ADSL services in California as a part of its “unfolding data strategy.”<sup>48/</sup>

Now and for some time to come, SBC and Ameritech, like other ILECs, will have a virtually complete monopoly over these services, especially for residential and small business customers. Their control will remain regardless of whether the Commission grants the ILECs any relief from the requirements of section 251 (for example, with respect to access to xDSL-equipped loops and resale of advanced services), although such relief would further cement their monopoly chokehold over high-speed digital loop-based services. Neither SBC nor Ameritech has met its most basic obligations under section 251(c) to provide unbundled access to xDSL-capable loops and collocation on reasonable and nondiscriminatory terms, including cost-based rates:

- Neither has deployed efficient, nondiscriminatory systems to give competing providers of advanced services access to xDSL-capable loops on the same terms and conditions as the ILEC or any ILEC data services affiliate.

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47/ “Ameritech Expands Data Offerings, Unveils Commercial ADSL,” Ameritech Press Release, October 5, 1998, <http://www.ameritech.com/media/releases/release-1637.html>. According to Ameritech, its strategy to achieve its goal of “\$1.5 billion in data revenue in 1998” is “to provide businesses compete solutions that leverage our network management skills and advanced broadband networks.” *Id.*

48/ “SBC Communications Announces Broad ADSL Deployment Across California,” SBC Press Release, May 27, 1998, [http://www.sbc.com/News/Article.html?query\\_type=article&query=19980527-02](http://www.sbc.com/News/Article.html?query_type=article&query=19980527-02). Ironically, SBC’s press release asserts that ADSL service will eliminate “the local access *bandwidth* bottleneck,” *id.* (emphasis added), even though SBC’s efforts are aimed at solidifying its bottleneck control over the local market itself.



- Neither conditions loops for competing providers on the same basis as it conditions loops for its own local services.<sup>49/</sup>
- Neither permits CLECs to place equipment on efficient and nondiscriminatory terms in ILEC end offices DSLAMs and other equipment necessary to provide xDSL services.
- Neither permits CLECs to place equipment in remote terminals so that CLECs can provide xDSL service to customers served by Integrated Digital Loop Carrier systems.

SBC's and Ameritech's failure to comply with section 251 effectively precludes competitors from competing to provide advanced local services.

It will likely take SBC, Ameritech, and other ILECs at least several years to make xDSL-capable loops, collocation in central offices and remote terminals, and other xDSL-related elements and services available on reasonable and nondiscriminatory terms, so it will likely take effective competition in xDSL services at least several years to develop. Regardless of whether SBC, Ameritech, and other ILECs obtain forbearance from current requirements under section 251(c), their monopoly over xDSL services is likely to continue because it will take time to bring them into compliance with the requirements with which even they admit they must comply. Developing the systems related to providing xDSL-capable loops is at least as complicated as providing unbundled voice-grade loops on reasonable and nondiscriminatory terms, and regular voice-grade loops are not available as an unbundled network consistent with the requirements of section 251(c) more than two years after the 1996 Act was passed. It may well take at least as long to work out all the operational and pricing issues relating to xDSL elements and services.

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<sup>49/</sup> Indeed, SBC now disputes that it is obligated to condition loops for CLECs because that would give them "superior access" to this network element, even though SBC itself is apparently conditioning loops for its own xDSL service. *See* Petition for Reconsideration of SBC Communications Inc., Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell, *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket 98-147 *et al.* (filed Sept. 8, 1998).

The uncooperative and obstructionist attitude of ILECs like SBC and Ameritech has made provision of access to central offices and remote terminals on reasonable and nondiscriminatory terms an equally difficult problem. Of course, if the Commission rejects (as it should) ILEC demands that they be relieved of the requirements of section 251(c) with respect to this category of local services, SBC, Ameritech, and the other ILECs will have even more work to do to bring themselves into compliance, and in the meantime, their ISP business will continue to benefit from favorable treatment from their local telephone business.

SBC's and Ameritech's continuing monopoly over advanced high-bandwidth services gives them, like other ILECs, a major advantage particularly in serving residential consumers and small business customers for whom T-1 and other traditional high-bandwidth services are not cost-effective. Not surprisingly, they are using this advantage to increase their Internet business. Both SBC and Ameritech are already bundling residential xDSL service with Internet access service by the ILEC's data affiliates,<sup>50/</sup> and both are blatantly steering consumers to their own ISPs. On the residential-oriented portion of Ameritech's World Wide Web site, ADSL service is offered *only* as part of a package with Internet access service from Ameritech.net.<sup>51/</sup> SBC/PacBell's Web site at least acknowledges that xDSL service might be used to reach an ISP other than Pacific Bell Internet, but SBC makes clear that customers that use its xDSL service to access competing ISPs will pay *hundreds of dollars* more in up-front fees than customers who

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<sup>50/</sup> See [http://www.ameritech.net/visitors/adsl/adsl\\_faq.htm](http://www.ameritech.net/visitors/adsl/adsl_faq.htm); [http://public.pacbel.net/faq/dsl\\_faq.html](http://public.pacbel.net/faq/dsl_faq.html). Bell Atlantic and GTE also bundle ADSL service with their own ISPs' Internet access service. See [http://www.bell-atl.com/adsl/more\\_info/pricing.html](http://www.bell-atl.com/adsl/more_info/pricing.html); <http://www.bbn.com/aboutbbn/presskit/980413.htm>. These World Wide Web pages are attached hereto as part of Exhibit 3.

<sup>51/</sup> See <http://www.ameritech.com/products/data/adsl/index.html>. It is possible that Ameritech would in fact permit a consumer to obtain ADSL service for use with another ISP, but one cannot easily, if at all, determine that from its Web site. This World Wide Web page is attached hereto as part of Exhibit 3.

choose Pacific Bell Internet.<sup>52/</sup> SBC/PacBell compounds its price discrimination with its misleading marketing claim that customers should choose Pacific Bell Internet for ADSL service because it was the first ISP in California to provide ADSL service and it has nearly two years experience in providing the service — without bothering to mention that Pacific Bell Internet's parent company used its control of the ADSL bottleneck to deny the service to other ISPs and their customers.

The Commission has already received extensive confirmation of the risk that ILECs will abuse their monopoly power over xDSL service to enhance their ISP business. In its comments in the Commission's section 706 proceedings, the Minnesota Department of Public Service detailed the monopoly abuses that are the subject of the formal complaint that it and the Minnesota Office of the Attorney General filed with the Minnesota Public Utilities Commission against U S West:

- U S West activated USWEST.NET's ADSL connection before any other ISP, and even in advance of the effective date of the tariff permitting the service;
- U S West provisioned its own ISP with necessary facilities "much sooner than it did for independent ISPs;"
- U S West timed a "free modem" promotion (similar to SBC's and Ameritech's) in a way that customers of ISPs other than USWEST.NET were almost entirely excluded, the result of which was that "the overwhelming majority of end user customers who participated in U S WEST's promotion went to USWEST.NET as their ISP;" and

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<sup>52/</sup> Compare [http://public.pacbell.net/dedicated/dsl/dsl\\_solutions.html](http://public.pacbell.net/dedicated/dsl/dsl_solutions.html) (\$299 for installation and all necessary hardware if the user signs a one year contract with Pacific Bell Internet) with <http://www.pacbell.com/products/business/fastrak/adsl/pricing.html> (\$660 for installation and all necessary hardware to choose a different ISP). These World Wide Web pages are attached hereto as part of Exhibit 3. SBC is not the only ILEC to offer a blatant price discount on ADSL service if the customer chooses the ILEC's ISP: Bell Atlantic discounts the equipment by hundreds of dollars and offers *free* installation if the customer signs up for one year of service from Bell Atlantic.net.

- U S West's marketing of xDSL service heavily favored its own ISP.<sup>53/</sup>

The Public Utility Commission of Texas explained other ways in which an ILEC could abuse its monopoly power over xDSL service to favor its own ISP:

For example, to offer xDSL-based information services it is important to be aware of loop characteristics like the presence of bridge taps, load coils, etc. Depending upon the presence of such loop characteristics, the loop may need to be conditioned to make it suitable for offering xDSL-based information services. The ILEC may condition the loop and the advance services affiliate may deploy xDSL network elements (*e.g.*, digital subscriber line access multiplexers or DSLAMs) primarily in an area of interest to the affiliated information services provider. This action gives the ILEC's affiliates a strategic advantage over their competitors.<sup>54/</sup>

Similarly, the Indiana Utility Regulatory Commission voiced significant concerns about favoritism among Ameritech affiliates in the provision of xDSL services.<sup>55/</sup>

If xDSL services become the predominant method of access to Internet services, and the merged company leverages its monopoly over these services to capture the Internet business of these captive local customers, SBC-Ameritech will seize such a large and disproportionate share of Internet traffic that it may achieve market power over Internet services. By increasing Internet traffic from customers locked into SBC-Ameritech's Internet service through bottleneck abuse, the merger may give SBC-Ameritech the ability to exploit a lopsided share of Internet traffic in its dealings with other ISPs that need to exchange Internet traffic with it.

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<sup>53/</sup> *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket 98-147 Comments of the Minnesota Department of Public Services, at 7-11 and Appendix A(submitted Sept. 25, 1998).

<sup>54/</sup> Comments of the Public Utility Commission of Texas, *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, at 2-3 (submitted Sep. 24, 1998).

<sup>55/</sup> See Comments of Indiana Utility Regulatory Commission and the Technical Staff of the Public Service Commission of Wisconsin, *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability* CC Docket No. 98-147 (submitted Sept. 24, 1998), at 6-9.

The merger will significantly increase the percentage of Internet customers to which SBC-Ameritech controls access, and that percentage is certain to grow as xDSL technology is more widely deployed. With xDSL services as the preferred form of Internet access for a substantial group of users, the merger could begin a process that results in increasing numbers of Internet users moving to SBC-Ameritech not because it offers better prices or superior service, but because SBC-Ameritech has successfully raised the costs of rival ISPs, particularly those not part of other mega-BOCs. Increasing the costs of other ISPs that lack bottleneck control could in turn force those ISPs to raise their retail prices for Internet access and thereby cause a general increase in the retail prices. Or, alternatively, SBC-Ameritech could use its anticompetitive price advantage to capture Internet business both inside and outside its region and then raise retail Internet prices to the extent it acquires market power. In either event, consumers would be the losers.

If both SBC-Ameritech and Bell Atlantic-GTE are allowed to proceed with their mergers, the risk to Internet competition would increase substantially because the greater the consolidation of the remaining major ILECs, the greater the risk of coordinated interaction. *See* Section II.C above. To the extent that the Commission cannot draw a meaningful distinction between the two mergers, approval of the SBC-Ameritech merger would mean approval of the Bell Atlantic-GTE merger. Even if SBC-Ameritech by itself would not achieve national market power over Internet services, SBC-Ameritech and Bell Atlantic-GTE together would control access to 70 percent of all Internet users. The shrinking number of ILECs that exercise bottleneck control over Internet access could facilitate coordinated interaction among the remaining mega-BOCs. In particular, SBC-Ameritech and Bell Atlantic-GTE could agree to exchange Internet traffic with each other on more favorable terms than they exchange traffic with non-bottleneck ISPs. The result could be

an effective Internet duopoly with SBC-Ameritech and Bell Atlantic-GTE impeding the ability of other ISPs to compete for the business of end users and content providers. *See* Baseman-Kelley Decl. ¶ 102.

**B. Applying inflated access charges to local Internet access would increase the risk that mega-BOCs would achieve market power over Internet services.**

The ability of ILECs to leverage their monopoly control over local services into market power over Internet services will be increased if they succeed in their current efforts to extend the current system of excessive access charges to calls from Internet users to their ISPs. By inflating the costs of competing ISPs, BOCs that provide Internet service along with local service would gain the same ability to impede Internet competition that BOCs have to impede competition in the long-distance market by unaffiliated long-distance carriers. The merger would mean that this type of leveraging by SBC-Ameritech would give it an even greater undeserved share of the Internet business and further threaten the ability of equally efficient and innovative ISPs to compete against the merged company.

By squeezing competing ISPs that must pay excessive access charges, and by tying its ISP service to advanced methods of Internet access, the combined SBC-Ameritech threatens to appropriate enough Internet traffic to give it power in the national market for Internet services — if not unilaterally, then through coordinated interaction with other mega-BOCs. The increase in Internet traffic resulting from merger could give SBC-Ameritech power (a) to extract more favorable terms from Internet content providers, outside as well as inside SBC-Ameritech's region, because users in SBC-Ameritech's expanded region can get access to their content only through SBC-Ameritech's expanded bottleneck, or (b) to capture the business of content providers from equally or more efficient ISPs because SBC-Ameritech hinders their ability to

provide competitively-priced connectivity to a large number of Internet customers held captive by SBC-Ameritech. By using its artificial merger-enhanced advantage to capture more business from content providers, SBC-Ameritech will increase its importance to other ISPs and to Internet end users and thereby gain additional power to increase the costs of other ISPs and raise retail prices. This process could result in tipping the market more and more toward SBC-Ameritech until it acquires monopoly power.<sup>56/</sup>

Simply as a result of the merger, SBC-Ameritech would have a significantly greater share than either company would have without the merger. Although it is difficult to predict exactly how much and how quickly SBC-Ameritech's share of total Internet traffic would grow after the merger, SBC and Ameritech have not shown that the combined company's share of the Internet business would be so small as to eliminate the tipping concern. It is also clear that the risk of anticompetitive effects would be greatly increased if the Commission permits the Bell Atlantic-GTE merger, because the risk of coordinated interaction would increase, as explained above.

Consistent with the public interest standard in section 310(d), the Commission has a duty under section 706(a) of the Telecommunications Act of 1996 to use its regulatory authority to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans." The proposed SBC-Ameritech merger threatens to create a substantial barrier to infrastructure investment. Consistent with the congressional directive in

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<sup>56/</sup> Opponents of the MCI-WorldCom merger claimed that combining MCI's and WorldCom's Internet business would produce a similar network tipping effect. *See MCI-WorldCom Order* ¶¶ 147-150. Here, however, customers and ISPs would have no choice but to deal with SBC-Ameritech for the first or last mile of Internet connections. In contrast, customers and ISPs did have alternatives to MCI and WorldCom for Internet backbone services. Thus SBC-Ameritech's control over local access to its customers would be far more complete than that of any large interLATA backbone provider, and the resulting threat to competition far more substantial. Nevertheless, even in the context of an interLATA backbone provider facing intense competition, the Commission required complete divestiture of any Internet overlap as a condition of the MCI WorldCom merger.

section 706(a), the Commission should use its authority over the requested transfer of control to prevent the formation of this barrier.

**V. THE COMMISSION SHOULD DISAPPROVE THE SBC-AMERITECH MERGER.**

As explained above, the proposed merger between SBC and Ameritech raises a variety of serious threats to competition in local, Internet and long-distance markets. The most straightforward way to eliminate these threats, and to do so without regulatory conditions whose enforcement would consume substantial Commission resources, would be for the Commission simply to disapprove the merger.

To the extent the Commission considers approving the merger with conditions, the Commission should seriously consider structural conditions that would affirmatively boost competition. An alternative to structural conditions would be behavioral conditions that require SBC-Ameritech to take specified procompetitive actions or prohibit it from taking specified anticompetitive actions. It is difficult to imagine any reasonably enforceable behavioral conditions that, individually or in combination, would be sufficient to make the merger affirmatively procompetitive. Unlike structural conditions, behavioral conditions require on-going regulatory oversight and enforcement because their goal is to make monopolists act contrary to their basic economic interests. It is therefore perhaps unsurprising that behavioral conditions have not been effective in the context of ILEC mergers.<sup>57/</sup> Bell Atlantic has not complied with the behavioral

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<sup>57/</sup> The fact that SBC and Ameritech do not suggest that barriers to entry for their “national local” strategy are lower in Bell Atlantic’s region suggests that the merger conditions have had little practical effect. See Baseman-Kelley Decl. ¶¶ 6, 61n. 34, 82.



conditions imposed in connection with its merger with NYNEX and has even contended that it may flout them with impunity because the Commission lacks the authority to enforce them.<sup>58/</sup>

Although it is not clear that all the problems inherent in a behavioral approach can be corrected, experience with the Bell Atlantic-NYNEX merger conditions makes clear that at least two changes are necessary. First, any behavioral conditions on ILEC mergers would have to be very specific. For example, it was not enough to require in general terms that Bell Atlantic set rates for unbundled network elements based on unspecified forward-looking costs, or that Bell Atlantic negotiate in good faith about meaningful performance measurements, standards, and remedies. Second, any conditions must be implemented *before* the merger closes. Once two major ILECs merge, they lose all incentive to comply with the conditions, and the merged company would come up with one reason after another why compliance is infeasible or should be delayed. As a practical matter, the Commission can most effectively enforce any behavioral conditions before the ILECs complete a proposed merger.

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<sup>58/</sup> See *MCI Telecommunications Corp. et al. v. Bell Atlantic Corp.*, File No. E-98-12, Complaint (filed Dec. 19, 1997) (Bell Atlantic failed to implement forward-looking TELRIC pricing); *MCI Telecommunications Corp. et al. v. Bell Atlantic Corp.*, File No. E-98-32, Complaint (filed Mar. 17, 1997) (Bell Atlantic failed to negotiate in good faith performance standards, remedies and associated reporting); *MCI Telecommunications Corp. et al. v. Bell Atlantic Corp.*, File No. E-98-32, Brief of Bell Atlantic (filed Oct. 2, 1998) (asserting that Commission lacks jurisdiction to enforce certain merger conditions). The problems addressed in these complaints are not the only ways in which the Bell Atlantic-NYNEX merger conditions have failed to work as the Commission hoped. MCI WorldCom has encountered problems with Bell Atlantic in a host of areas, including with non-recurring charges (where Bell Atlantic has inflated the amounts billed under the recurring payment option) and performance monitoring (where Bell Atlantic refusal to provide data about the services and facilities it provides to itself prevents CLECs from determining whether they get equal treatment). Of course, the failure to date of major aspects of the Bell Atlantic merger conditions does *not* mean that the Commission should abandon its efforts to enforce these conditions and make them as effective as possible.

## CONCLUSION

The proposed merger of SBC and Ameritech would harm the public interest because it would reduce local competition and threaten Internet and long distance competition. The application of SBC and Ameritech should be denied or granted only subject to conditions that will ensure that the prospects for local competition are enhanced and that competition for Internet services is preserved.

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